Where should the European Union intervene to foster the internal market for eComms ?

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Where Should the European Union Intervene to Foster the Internal Market for eComms? (*)

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Abstract: This paper analyses when EU intervention is needed to achieve this internal market for electronic communications. It sets legal and economic criteria to determine the appropriate scope of the EU intervention. It applies these criteria to several case studies and concludes that sometimes the EU intervention is not always justified (such as regulation of mobile termination rate, price control of Next Generation Access networks), whereas in other cases EU intervention is justified (entry regulation, international roaming, spectrum). The paper calls for a more open debate of the concept and the means to achieve the digital internal market. It also submits that EU intervention should focus on the areas where its benefits are the highest (in particular given the possibilities of economies of scale provided by the technology or the cross-country externalities), and where its costs are the lowest (in particular given the heterogeneity of national preferences or the need for regulatory experimentation and competition). In particular, this paper calls the Commission to use its new power on regulatory remedies with extreme caution, especially in the context of the deployment of NGA, given the uncertainty on the best form of regulation.

Key words: electronic communications, internal market, regulation, subsidiarity, fiscal federalism.

Many European Commission policy initiatives and independent studies, of which this special issue of Communications & Strategies is an example, show a renewed interest in the progress towards the achievement of the internal market for digital services, whether on the content part (e.g. electronic commerce or e-government services) or on the infrastructure part (i.e. electronic communications networks and services). The Digital agenda for Europe, one of the seven

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flagship initiatives of the Europe 2020 Strategy for jobs and growth, places the internal market at its core. [1] Some of the 12 key actions of the recently adopted Single Market Act of the Commission should contribute to the digital single market. [2] Among the independent studies, the Monti Report on the internal market recommends several actions to shape Europe's digital single market. [3] According to Copenhagen Economics (2010), the EU could gain 4 % of GDP by stimulating the digital internal market by 2020. This corresponds to a gain of almost € 500 bn and means that the digital single market alone could have a similar impact to the famous Delors 1992 internal market programme.

To achieve such an internal market, several policies will be needed at the national and the EU levels. It is important that the EU intervention takes place where it is most useful; otherwise it may be counter-productive and waste the EU's "political capital", which has decreased over the years. Unfortunately in the past, the Commission sometimes intervened where, we would submit, it was not appropriate, whereas the Council opposed EU intervention in other areas where it was justified.

Accordingly, this paper identifies areas where EU intervention is justified and areas where national freedom of action would be more appropriate. The next Section explains our concept of the internal market with its implication for public policies, and then sets legal and economic criteria to base EU intervention. [4] The following Section puts forward some cases where EU intervention may be, according to us, over intrusive or other cases where EU intervention may be justified.

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1 Communication from the Commission of 26 August 2010, A Digital Agenda for Europe, COM(2010) 245/2.

2 Communication from the Commission of 13 April 2011, The Single Market Act, COM(2011) 206.

3 MONTI, 2010, pp. 44-46. With regard to telecommunications services and infrastructures, the Report recommends proposals for creating a seamless regulatory space for electronic communications, including proposals to reinforce EU level regulatory oversight, to introduce pan-European licensing and EU level frequency allocation and administration.

4 This paper does not deal with the different types of possible institutional coordination for the EU intervention ranging from weak to strong coordination : ad-hoc discussion of issues of common interest and/or mere exchange of information between national regulators; Euro-regulators with soft power (voluntary guidelines) and consensus decision making; Euro-regulators with hard power (binding rules) and qualified majority voting, Commission with softlaw; Commission with binding legislation, possibly after the opinion of the BEREC. On those categories, see Commission Services Impact Assessment of 28 June 2006 on the Review of EU regulatory framework for electronic communications networks and services, SEC(2006)817, pp. 19-21; and NICOLAIDES, 2006, p. 5.

The internal market in electronic communications and the optimal level of regulation

When dealing with the internal market, two related issues should be distinguished. First, what is the internal market and what does it imply for public policies at national and EU level? Secondly, when is EU intervention justified to achieve the internal market?

The concept of the internal market in electronic communications and the required public policies for its establishment

Article 26(2) of the Treaty on the Functioning of the European Union (TFEU) states that:

> "The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties."

The achievement of such internal market requires some public policies at the national as well as at the EU levels. We can find some indications in Article 8(3) of the amended Framework Directive[5], which provides that:

> "The national regulatory authorities shall contribute to the development of the internal market by inter alia:
>
> - removing remaining obstacles to the provision of electronic communications networks, associated facilities and services and electronic communications services at European level;
>
> - encouraging the establishment and development of trans-European networks and the interoperability of pan-European services, and end-to-end connectivity;
>
> - cooperating with each other, with the Commission and BEREC so as to ensure the development of consistent regulatory practice and the consistent application of this Directive and the Specific Directives."

More generally, the national and EU policies necessary to achieve the internal market for public policy need to be debated further between stakeholders but, at this stage, we argue that the conditions and policies for

5 Directive 2002/21 of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services, *OJ* [2002] L 108/33, as amended by Directive 2009/140.

the achievement of the internal market in the electronic communications networks and services are:

- The removal of all barriers to entry between the Member States and the establishment of conditions which are sufficiently harmonised such that operators and consumers may benefit from the economies of scale (e.g. low cost mobile handsets available thanks to harmonised technical standards).

- A level playing field and strict non-discrimination between all players, being national or foreign, incumbent or new entrant, together with a high level of transparency on terms and conditions for access to key wholesale services, allowing effective competition.

- The presence of regulators which are independent of operators, to ensure the application of the non-discrimination and transparency rules, and of national governments.

However, the achievement of the internal market should not lead to the negation of national preferences and choices which are not contrary to the conditions defined above as necessary for the achievement of the internal market.

Such national preferences and choices may relate to economic regulatory issues where theoretical and policy debates exist, such as infrastructure *versus* service-based competition, the need and the speed for achieving the symmetry of termination charges, or the need of entry assistance measures such as national roaming are needed. An old example where the impact of the differences of national preferences on the internal market has been exaggerated is the 1998 Numbering Directive.[6] This Directive imposed on the Member States an obligation to implement Carrier Pre-Selection (CPS) by 2000. The United Kingdom, with a tradition of infrastructure-based competition, strongly opposed CPS as it was removing an incentive for operators to invest in local loops. The UK was outvoted in the Council and was forced to implement CPS. Whether the UK was right to oppose CPS is a matter of opinion. What is difficult to understand is why the British preference for a stronger incentive to investment in the local loop was an obstacle to the achievement of the internal market and why the country had to be brought into line.

6 Directive 98/61 of the European Parliament and of the Council of 24 September 1998 amending Directive 97/33 with regard to operator number portability and carrier pre-selection, *OJ* [1998] L 268/37.

National preferences may also relate to social policies. Thus, it is appropriate to let the Member States decide on the scope of the digital services of general economic interest they want to make affordable to their citizens, as long as it does not affect competition. [7]

Moreover, the achievement of the internal market should not be expected to lead to the harmonisation of prices. [8] Indeed, national differences in population density, GDP per capita, industry history and structure, consumer preferences and the fact that most electronic communications services are not tradable between Member States (thereby impeding any possibility of arbitrage) will inevitably result in differences in prices. To be sure, the prices of electronic communications services are geographically averaged across the national territory in most Member States although there are regional cost differences between, say, urban and countryside areas. However, this similarity in price is due to a political decision to impose geographic tariff averaging for social and territorial cohesion reasons among each Member State. The level of solidarity at EU level cannot justify a similar EU averaging. Furthermore, operators throughout the EU have different ownership which would make the administration of tariff averaging more complex.

The justification of an intervention at the EU level

The second issue is to determine when an intervention at the EU level is justified to achieve the internal market.

The legal criteria

In EU law, an intervention at the European level is justified when it passes two cumulative tests, the legal basis test (in particular the legal basis related to the internal market) and the subsidiarity test. [9] The legal basis test

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[7] Finland was the first EU Member State to include a broadband connection at 1Mbps in the definition of universal service.

[8] In this sense also, see the Opinion of Advocate General Poaires Maduro in Case C-58/08, The Queen (on the application of Vodafone and others) v. Secretary of State for Business, Enterprise and Regulatory Reform (*International Roaming Regulation*), ECR [2010] I-0000, para.32.

[9] We do not deal here with the principle of proportionality of Article 5(4) TEU because it is not related to the existence or the possibility to exercise EU competence, but to the manner this competence should be exercised.

determines whether the EU has a competence to act, whereas the subsidiarity test determines whether the existing competence may be exercised, hence the former precedes the latter.

The legal basis for internal market, Article 114(1) TFEU [10], provides that:

> "The European Parliament and the Council shall (…) adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market."

In the *International roaming Regulation* case, [11] the Court of Justice interpreted this provision with a reasonably restrained economic interpretation:

> "32. According to consistent case-law the object of measures adopted on the basis of Article [114(1) TFEU] must genuinely be to improve the conditions for the establishment and functioning of the internal market […]. While a mere finding of disparities between national rules and the abstract risk of infringements of fundamental freedoms or distortion of competition is not sufficient to justify the choice of Article [114 TFEU] as a legal basis, the Community legislature may have recourse to it in particular where there are differences between national rules which are such as to obstruct the fundamental freedoms and thus have a direct effect on the functioning of the internal market […] or to cause significant distortions of competition […]. "
>
> 33. Recourse to that provision is also possible if the aim is to prevent the emergence of such obstacles to trade resulting from the divergent development of national laws. However, the emergence of such obstacles must be likely and the measure in question must be designed to prevent them […].

The Court of Justice followed the same line of reasoning in the ENISA case, the other case where the limits of Article 114 TFEU were tested in the electronic communications sector, by judging that [12]:

> "42. […] that provision is used as a legal basis only where it is actually and objectively apparent from the legal act that its purpose is to improve the conditions for the establishment and functioning of the internal market."

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10 On internal market, see CHALMERS *et al*., 2010.

11 Case C 58/08, *International Roaming Regulation*.

12 Case C-217/04, *United Kingdom v. European Commission and Council*, ECR [2006] I-3771, para. 42

If the legal basis test is met, then the subsidiarity test should be conducted. Article 5(3) of the Treaty on the European Union (TEU) provides that:

> "[…] the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level."

On the basis of those tests, two observations may be made:

- First, the relationship between the legal basis test and the subsidiarity test is complex because both tests have different objectives (determine whether there is an EU competence, and then whether this competence may be exercised), but the same elements may be considered to pass both tests. This was clear in the International roaming regulation case where the trans-national aspect of international roaming was considered both in the legal basis and in the subsidiarity tests.
- Second, both tests give some flexibility to the EU institutions to determine their competences. To use this flexibility in the most efficient way, some economic criteria may be useful, on which we now turn.

The economic criteria

To determine the economic criteria justifying an efficient EU intervention, we apply the theory of fiscal federalism which is the mainstream economic theory to determine efficiently the optimal level of governance and public intervention (ALESINA, ANGELONI & SCHUKNECHT, 2005; OATES, 1999, 2005; PELKMANS, 2005; TABELLINI, 2003. For an application in telecommunications, see BARROS, 2004; CAVE & CROWTHER, 1996; HAUCAP, 2009a: 466-472; NICOLAIDES, 2006). According to this theory, there are several benefits to centralisation (i.e. EU intervention) which are of substantive and institutional nature.

The substantive benefits are: [13]

- The internalisation of the cross-country externalities; there is such externality when the regulation (or the absence of regulation) in country A has significant effect on the welfare of the consumers and/or firms in

[13] We do not deal with the issue of regulatory race to the bottom, rarely applicable in the sector as the electronic communications networks and services are not tradable across countries.

country B and that effect will not be taken into account by the regulator of country A. One example is the regulation of international roaming.

- The costs saved by regulated operators with the elimination of regulatory duplication (one-stop-shopping or home-country control). An example of this would be a single EU authorisation procedure.

- The economies of scale and transaction costs saved by NRAs in the design of regulation and the implementation of such regulation. An example would be a common approach to cost auditing.

The institutional benefits are:

- The additional commitment and coherence as a centralised authority may be more independent and less prone to capture by local operators and governments.

- The institutional support for small or weak local regulators which may lack empowerment, skills, independence or accountability.

Besides reasons of economic efficiency, centralisation may also be justified for social motives. For instance, the averaging of telecom tariffs within a given Member State is justified for territorial cohesion.

However, centralisation also has some substantive or institutional costs. The substantive costs are due to:

- The heterogeneity of preferences and choices for economic or for social policies; a case in point is the different scope of the services of general economic interest among Member States.

- The heterogeneity of natural and historical endowments, such as speed and history of infrastructure deployment, spectrum allocation, market structures.

- The removal of the possibility for regulatory experimentation and innovation to detect and then possibly converge towards the most efficient form of regulation (ERG, 2006, p. 11). Allowing such experimentation is particularly essential when there is uncertainty about the appropriate regulation and the potential trade-off between competition and regulation. This is the case in sectors with technological rapid evolution such as electronic communications. For instance, the following concepts have been developed in one Member State and then copied in several others, and some became part of EU law: carrier (pre-)selection, interconnection charges based on Long Run Incremental Cost (LRIC), local loop unbundling, wholesale line rental, third-party billing, interconnection capacity based

charging (FRIACO), national roaming, or geographical market segmentation. The cost associated with the lack of regulatory experimentation due to premature harmonisation is sometimes forgotten in studies. [14]

Institutional costs arise because:

- The institutional capabilities and resources are often heterogeneous among Member States, in particular regulators of smaller Member states tend to have smaller financial and human resources, which may require the need for regulation that is simpler to implement (Ovum/Indepen, 2005: Section 6).
- The information asymmetry is usually higher at the central level than at the local level, for instance for cost information. For instance, violation of the principle of non-discrimination often concerns practical issues of details for which a national regulator is better placed to collect the relevant evidence.
- Accountability is, in some cases, lower at the central level than at local level.
- Central procedures have a lower responsiveness and flexibility than local procedures.
- Centralisation risks creating an additional (central) layer of regulation without removing the local level of regulation, leading to more regulation and additional complexity (Eurostrategies / Cullen International,1999).

Thus, for each policy, or part of an overall policy, the benefits and the costs of centralisation should be balanced to determine the optimal level of regulation. [15] Often that choice is not always clear cut and may entail trade-offs among efficiency arguments or between efficiency and social arguments. Moreover, this choice is complicated by an endogeneity (i.e. circularity) issue because, if the costs and benefits of centralisation should determine the optimal level of governance, the decided level of governance will in turn influence the costs and benefits of centralisation. Indeed in some cases, centralisation may stimulate additional central economic activities which, in turn, will justify more centralisation.

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[14] For instance European Evaluation Consortium (2007, pp. 21-24) does a cost-benefit analysis of the harmonisation of remedies without taking into account the benefit of regulatory experimentation.

[15] Note that in general, industry is less keen of centralisation than the Commission. Eurostrategies/Cullen International, 1999; Hogan & Hartson and Analysys, 2006, p. 91. ALESINA, ANGELONI & ETRO, 2001, discuss the possibility of centralisation bias in the Union.

The practice of EU intervention in the regulation of electronic communications

After having dealt with the legal and economic criteria justifying EU intervention, we now assess whether those criteria have been applied in practice by the EU institutions. In the first sub-section, we deal with cases where EU intervention has been over-intrusive, whereas in the second sub-section we deal with cases where EU intervention was justified.

Some cases where EU intervention is not always justified

The choice of remedies in the national market analysis

According to the Framework Directive, the Commission may review NRA market analyses that could affect trade between Member States [16]. Those are:

> "Measures that may have an influence, direct or indirect, actual or potential, on the pattern of trade between Member States in a manner which might create a barrier to the internal market. They comprise measures that have a significant impact on operators or users in other Member States, which include, inter alia: (i) measures which affect prices for users in other Member States; (ii) measures which affect the ability of an undertaking established in another Member State to provide an electronic communications service, and in particular measures which affect the ability to offer services on a transnational basis; (iii) and measures which affect market structure or access, leading to repercussions for undertakings in other Member States." [17]

During this review, the Commission may comment and possibly, in a second stage, veto the market definition and the market power assessment in the NRA draft measure which would create a barrier to the single market or not be compatible with EU law [18]. Moreover, where the Commission finds that divergences in the implementation by the NRAs of the regulatory tasks create a barrier to the internal market, the Commission may issue a recommendation or, regarding numbering and remedies in the market analysis, a binding decision on the harmonised application of the EU

16 Art. 7(3) of the amended Framework Directive 2002/21.

17 Recital 38 of the original Framework Directive 2002/21.

18 Art. 7(4) and (5) of the amended Framework Directive 2002/21.

provisions in order to further the achievement of the main objectives of the EU regulation (effective competition, internal market, citizens' interests) [19].

In practice, the Commission adopts a very broad interpretation of the concept of "measures that could affect trade between Member States". It grants itself the competence to review all NRAs' draft market analyses [20] without really investigating the effects on trade between Member States on a case by case basis. However, differences in regulatory regimes have never prevented the establishment of pan-European telephone calls or other forms of electronic communications, nor prevented cross-border takeovers across the European Union. It is somehow surprising that no Member State has ever challenged such extensive interpretation before the Court.

Moreover during its review, the Commission in practice conducts a consistency check between the different approaches of the NRAs rather than an investigation into whether the differences between NRAs' measures are such as to obstruct the fundamental freedoms, and thus have a direct effect on the functioning of the internal market or to cause significant distortions of competition. In its last Report on the market review process, [21] the Commission notes that:

> "Regulatory remedies still vary across Europe, even where the underlying market problems are very similar. This is a serious impediment to achieving a true single market."

However, the Commission does not articulate a precise rationale why a divergence in remedies or regulatory approaches on markets defined as being national would necessarily affect trade between member States and impede the single market. [22] According to us, the Commission's view is too broad. From a legal point of view, it does not correspond to the legal reasonably restrained economic interpretation given by the Court of Justice on internal market provision. From an economic point of view, it does not correspond to the balancing test of the theory of fiscal federalism, in

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19 Art. 19 of the amended Framework Directive 2002/21.

20 See Commission Guidelines of 9 July 2002 on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services, *OJ* [2002] C 165/6, para. 147 stating that "the notion of an effect on trade between Member States is likely to cover a broad range of measures". So far, all NRAs draft decisions have been notified to the Commission for comments.

21 Communication from the Commission of 1 June 2010 on market reviews under the EU Regulatory Framework (3rd Report), COM(2010) 271, p. 4.

22 See also the Opinion of Advocate General Poaires Maduro in Case C-58/08, *Roaming Regulation,* para. 18.

particular because such broad interpretation does not allow regulatory experimentation. [23]

Obviously, the situation is different in the case of transnational markets [24] where EU intervention is more easily justified. This is, for instance, the case for satellite communications which have a de facto pan-European footprint and the costs of serving one national zone or several ones are largely fixed. The 2008 Parliament and Council decision setting out a single selection procedure at EU level for Mobile satellite services (MSS) operators was a faltering step in the right direction. The selection is done by the Commission in coordination with Member States via Communications Committee. Following the selection procedure, operators should apply at national level for the right to use specific radio frequencies and the right to operate mobile satellite systems. In addition to frequency rights and authorisations, Member States should also grant to operators the authorisations to operate complementary ground components of mobile satellite systems on their territories. [25]

Trans-national market may also apply to the provision of services to 'high-end' business users (typically multinational companies) which would perhaps benefit from a stronger EU intervention, as argued by some. [26] However, it should be recalled that the majority of electronic communications markets remain national or regional, and that is not necessarily due to differences in national regulation but mainly to product characteristics (local infrastructures).

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[23] In this sense also, LAROUCHE & VISSER, 2006, stating that, "the Commission should intervene only when the draft measure proposed by an NRA is such that it will hamper the internal market (on the basis of concrete evidence) or that it will significantly conflict with Community law. A mere divergence of opinion between the Commission and the NRA (or between NRAs) is not sufficient to justify a Commission veto".

[24] Article 2(b) of the amended Framework Directive defines 'transnational markets' as covering the Community or a substantial part thereof located in more than one Member State. For an assessment of the cost and benefits of an EU intervention on trans-national services, see European Evaluation Consortium, 2007, pp. 25-27 and 31-33.

[25] Decision 626/2008 of the European Parliament and of the Council of 30 June 2008 on the selection and authorisation of systems providing mobile satellite services (MSS), O.J. [2008] L 172/19, and Commission Decision 2009/449 of 13 May 2009 on the selection of operators of pan-European systems providing mobile satellite services (MSS), O.J. [2009] L149/65. The two operators selected are Solaris (joint venture between Eutelsat and SES) and EuropaSat (Inmarsat). Solaris Mobile is experiencing some technical problems which limit the bit rate on the uplink. Europasat satellite is still being built. Consequently perhaps, 21 of the 27 Member States have failed to grant Solaris and EuropaSat a licence.

[26] BEREC Report of February 2011 on relevant market definition for business services, BoR (10) Rev1.

A first specific application on regulatory remedies: the regulation of the Mobile Termination Rates

The argument is often heard that Mobile Termination Rates (MTRs) vary from country to country by several hundred percent and that this is evidence of widely diverging national policies which would undermine the internal market (See, among others, PELKMANS & RENDA, 2011).

We submit first that national policies are not widely divergent. All Member States have followed the same policies of imposing glide paths for MTRs. In 2000, MTRs spread between 15 and 25 eurocents; as of July 2010, the weighted average was 5.65 eurocents and existing glide paths suggest most countries will be below 3 eurocents by 2014. So it is very much the same policy that is applied over the European Union, with only the speed of the adjustment varying from country to country. There is a consensus among NRAs on the need to reduce MTRs and it is possible that the Commission via its review on regulator market analysis has contributed to this.

We submit then that divergences among Member States may be justified and should be policed by the Commission. A number of NRAs have and are still setting higher MTRs in favour of late entrants on the markets. The Commission has for a long time opposed asymmetric MTRs, describing it as entry assistance, interfering unduly with market forces.

Yet in a number of markets, such as France and the UK, in spite of the asymmetry in MTRs, late entrants on the markets have been net out payers of MTRs to early entrants. This is due to the existence of on-net retail prices. Consumers prefer larger operators so that a higher proportion of their calls is covered by on-net retail prices. This so-called 'club effect' is magnified by the gap between costs and the MTRs. This creates an artificial handicap for the smaller operators and creates a vicious circle: the smaller their market share, the less attractive their offerings. This forces late entrants to offer all-net prices to increase the attractiveness of their offerings. This means that a late entrant's clients are indifferent between on-net and off-net calling, while an early entrant's clients tend to avoid off-net calls. This results in a traffic imbalance and a net out payment from the late to the early entrants. This is the justification brought forward by regulators defending an asymmetry of MTRs. The Commission is unconvinced and argues that the market share of a given mobile operator is a variable under its control. To consolidate its position, the Commission has adopted, against the majority of the Member

States, a non-binding recommendation on the regulation of fixed and mobile termination. [27] The Commission states that, to determine the minimum efficient scale for the purposes of the cost model, and taking account of market share developments in a number of EU Member States, the recommended approach is to set that scale at 20% market share. Furthermore, even the Commission acknowledges that asymmetry can be justified for a period of up to four years after market entry.

Mobile Challengers, the association for late entrants on mobile markets, point out that there are very few, if any, examples of a number 3 or 4 entrant in an EU market ever gaining the second largest market share in revenues. Therefore, a longer transition period is needed in the interest of long term competition. This raises the question of how long that transitional period could reasonably be. Mobile Challengers is asking for asymmetry of MTRs as long as MTRs are set above costs [28].

The Commission justified its intervention to ensure legal certainty and the right incentives for potential investors. [29] However, the discussion above shows that there are two schools of thought, [30] with valid arguments on both sides, hence regulatory experimentation by Member States is justified. Moreover, there are no counterbalancing arguments justifying EU regulation as it is hard to see why a difference of 25% in the MTRs of two mobile operators in the same country aimed at balancing interconnecting payments could have a material effect on the internal market. Similarly, Haucap (2009b:30) states that:

> "It is simply unrealistic to assume that the regulation of MTRs would be used as a tool of strategic regulatory policy by NRAs. Hence, cross-border externalities provide no economic justification for harmonising MTR regulation at a European level."

Thus, we argue that the Commission call for symmetry of MTRs in that Recommendation is not justified because its benefits are very small (in terms

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27 Commission Recommendation 2009/396 of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU, *O.J.* [2009] L 124/67. The result of the vote at the Communications Committee of 18 February 2009 was: 12 Member States against, 10 abstentions, and 5 in favour.

28 See http://www.mobilechallengers.eu/images/stories/Barcelona09presentation.pdf

29 Recital 4 of the Recommendation 2009/396 on the Regulatory Treatment of Termination Rates.

30 For a summary of the debate in the economic literature on the regulation of MTR, see HAUCAP, 2009, p. 31.

of cross-country externalities, or economies of scale/savings of transaction costs), but its costs may be high (complicated system, no possibility of regulatory experimentation by Member States). [31]

A second specific application of regulatory remedies: Next-Generation Access Networks and the migration between copper and fibre - pricing

The current debate on the relative prices of copper and fibre loops provides another good illustration of a field where several schools of thought exist and where there can be room for national preferences and experimentation. There will be a form of platform competition between copper-based current generation access (CGA) and fibre-based next generation access (NGA). Regulated wholesale prices will be one important factor influencing the pace of the migration from CGA to NGA. At this stage, the European Commission and many national regulators are unclear as to whether lower CGA prices (resulting from a different regime of cost accounting) would speed up fibre roll-out as argued by ECTA (the trade association presenting alternative operators) (HOERNIG *et al.*, 2011) or whether, on the contrary, stable or even higher copper prices (resulting from fewer customers sharing the fixed costs of CGA) would drive customers to NGA, as argued by ETNO (the trade association representing the incumbent operators) (WILLIAMSON, BLACK & WILBY, 2011). The implementation of cost orientation implies decisions at four different levels. Furthermore, at each level, several options exist:

- cost source, e.g. top down (based on the actual accounting of the operator) or bottom up (engineering model);
- cost base, e.g. Fully Distributed Costs (FDC), Stand Alone Costs (SACs) Long Run Incremental Costing (LRIC);
- depreciation method, e.g. historical costs (HCA), current costs (CCA); and
- price control type, e.g. cost orientation, retail minus.

For CGA, in its 2009 recommendation on termination rates, the Commission has advocated a precise combination of bottom up, LRIC, current costs with a price control based on cost orientation. [32] In its 2010

[31] IRG/ERG Response of September 2008 to Public Consultation on Termination Rates, ERG(08) 31 rev1 stating that: "the development of the internal market […] is best achieved by ensuring that national decisions are taken on the basis of shared principles, rather than requiring uniformity in the fine detail of the regulatory approach".

[32] Commission Recommendation 2009/396 on the Regulatory Treatment of Termination Rates.

recommendation on NGA, the Commission wisely refrains from being too specific and simply refers to cost orientation. [33] In the absence of a reasonable consensus, the Commission was right to leave each NRA free to pursue the policy which, they believe, will foster investment in NGA in their own country. In view of the relative uncertainty of the optimal combination of cost accounting concepts and on the assumption that all NRAs are really pursuing competition, we submit that the Commission should not issue similar strict guidance on fibre – in particular on the relative prices of fibre and copper - as part of its upcoming recommendation on cost methodologies for key access products.

Cases where EU intervention is justified

The regulation of market entry

Home-country control procedures are an extension of the Cassis de Dijon doctrine [34] to services. Throughout the 1990s and 2000s, the extension of the doctrine to services was seen in many sectors ranging from audiovisual to electronic commerce services. [35] In the field of electronic communications services, the Commission tabled in 1992 a proposal for a mutual recognition of licences whereby a telecommunications operator duly authorised in its home country would be authorised to provide services in other Member States. However, the initiative was strongly opposed by the Member States. Therefore in 1994, the Commission proposed another option which was to harmonise national licensing conditions. Since licensing conditions would have been the same in every Member State, operators would have been able to operate across borders without obstacles. After an unsuccessful attempt by the European Telecommunications Office – a CEPT body based in Copenhagen – to harmonise licences, the idea was abandoned.

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33 Commission Recommendation 2010/572 of 20 September 2010 on regulated access to Next Generation Access Networks (NGA), O.J. [2010] L 251/3. On the additional national flexibility given by each iteration of the Recommendation, see CAVE & SHORTALL, 2010.

34 Named after the Case 120/78 *Rewe Zentral c. Bundesmonopolverwaltung für Branntwein*, ECR [1979] 649.

35 Directive 2007/65 of the European Parliament and of the Council of 11 December 2007 amending Council Directive 89/552/EEC on the coordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the pursuit of television broadcasting activities, *OJ* [2007] L 332/27; Directive 2000/31 of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market, OJ [2000] L 178/1, Art. 3.

In November 1995, the Commission tabled a third proposal which led to the adoption of Directive 97/13. [36] The approach was to try to limit the range of conditions that Member States could impose on operators to what is strictly needed to ensure consumer protection, network integrity, security of staff, prevention of anti-competitive behaviours, measures for disabled people... The same approach was taken over in the current Authorisation Directive. [37] In practice, the cost for industry of having that third option is probably not much higher than having a regime of mutual recognition or a fully harmonised regime. This is because the procedure for obtaining an authorisation has become much lighter than in the early 2000s. Furthermore, compliance costs would be relatively equal under the three regimes since it is anyway the responsibility of each national regulator to undertake the surveillance of its own market.

International roaming

Beyond unregulated competitive offerings by individual companies' initiatives such as Vodafone Passport, the industry failed to propose a market-based solution to meet the concerns of consumers and politicians about high retail roaming prices for voice telephony and SMS in the EU. Thus in June 2007, a binding regulation setting ceiling prices at both retail and wholesale level for international mobile roaming voice calls was adopted by the European Parliament and the Council. [38] The validity of this regulation, and more generally the validity of intervention at the EU level, was confirmed by the Court of Justice in June 2010. The Court [39] judged that the International Roaming Regulation was justified because divergent national policies would have targeted the retail level and would have caused distortions of competition among operators:

> "47. As regards the functioning of the roaming market […] and taking into consideration the considerable interdependence of retail and wholesale charges for roaming services, it is clear that a divergent

36 Directive 97/13 of the European Parliament and of Council of 10 April 1997 on a common framework for general authorisations and individual licences in the field of telecommunications services, *OJ* [1997] L 117/15.

37 Directive 2002/20 of the European Parliament and of the Council of 7 March 2002 on the authorisation of electronic communications networks and services *OJ* [2002] L 108/21, as amended by Directive 2009/140.

38 Regulation 717/2007 of the European Parliament and of the Council of 27 June 2007 on roaming on public mobile telephone networks within the Community and amending Directive 2002/21/EC, OJ [2007] L 171/32, as amended by Regulation 544/2009.

39 Case C 58/08, *International Roaming Regulation*, para.47.

> development of national laws seeking to lower retail charges only, without affecting the level of costs for the wholesale provision of Community-wide roaming services, would have been liable to cause significant distortions of competition and to disrupt the orderly functioning of the Community-wide roaming market […]"

EU intervention is also justified on the basis of the economic criteria of the fiscal federalism as the regulation of international roaming is a typical case of direct externalities between countries. If a Member State caps prices for international roaming in its own territory, the beneficiaries are foreign consumers; while domestic mobile operators suffer as do domestic consumers since – in response to a decrease in roaming revenues – other mobile telecommunications prices may increase or handset subsidies decrease due to the waterbed effect (HAUCAP, 2009a, p. 471). [40] While acknowledging the 'dirigiste' approach of the International Roaming Regulation and its departure from the market-based approach promoted by the EU for other electronic communications services, it is fair to recognise that competition in this sector has so far failed. The industry seems to have learned the lesson and a number of attractive commercial offerings have recently been launched on the mobile data side.

Spectrum

Another example of an appropriate EU intervention is the recently proposed decision on the Radio Spectrum Policy Program. [41] One of the RSPP's most important objectives is to make the 800 MHz band available for wireless broadband by January 2013. In May 2010, the Commission adopted a Decision [42] setting harmonised technical conditions for the use of the 800 MHz band for non-broadcasting services, in particular for wireless broadband services using 4G technologies (e.g. LTE). [43] The decision does

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[40] Such cross-countries externalities have been explicitly recognised by the Opinion of Advocate General Poiares Maduro in Case 58/08 *International Roaming Regulation*, para. 27. The Advocate-General insists several times on the cross-border nature of roaming for the regulation to pass the legal basis and the subsidiarity test.

[41] Commission proposal of 20 September 2010 for a decision establishing the first radio spectrum policy programme COM (2010) 471.

[42] Commission Decision 2010/267 of 6 May 2010 on harmonised technical conditions of use in the 790-862 MHz frequency band for terrestrial systems capable of providing electronic communications services in the European Union, *O.J.* [2010] L 117/95.

[43] The 800 MHz (790-862 MHz) band is the upper part of the spectrum that will be freed up with the switchover from analogue to digital terrestrial television broadcasting – the digital dividend.

not require Member States to open the 800 MHz band for non-broadcasting services but if/when a Member State does decide to, it must follow the technical conditions set by the Decision. The RSPP, however, would mandate the implementation of the decision to clear the 800 MHz band by January 2013. One of its main goals is to make spectrum available for wireless broadband services. We argue that the Commission's spectrum policy is justified because it aims at achieving economies of scale for network equipment and handsets, at minimising the problems of spectrum interference across borders and therefore at lowering costs that will benefit consumers.

■ Conclusion

To conclude, we submit that the internal market for electronic communications should be fostered as its benefits to the EU economy and its citizens far exceed the 2.8% of the EU GDP represented by the electronic communications sector. However, we call for a thorough and open debate on the definition of what constitutes the achievement of the internal market and the appropriate policies at the national and EU level. Today, there are divergent views but no real debate on the conditions required to achieve the internal market.

Europe needs to define more precisely when EU intervention is justified and when it is not. It needs to define more clearly which national policies constitute an unacceptable fragmentation of the internal market and what is merely the expression of national preferences and choices without any material impact on European welfare. It should do that on the basis of the legal criteria (the legal basis test – Article 114 TFEU- and the subsidiarity test). As the legal criteria give some flexibility, they may, for efficiency reason, be fine tuned with the criteria provided by the mainstream economic theory of fiscal federalism.

We submit that fostering the internal market for electronic communications does not mean that the EU law should address all regulatory issues. Any EU intervention, instead of national intervention, should focus on the areas where its benefits are the highest, in particular given the possibilities of economies of scale provided by the technology or cross-country externalities, and where its costs are the lowest, in particular given the heterogeneity of national preferences and choices or the need to

allow for regulatory experimentation. On that basis, we submit that EU intervention should be concentrated *inter alia* on spectrum policy, pan-European services (e.g. satellite communications) and international mobile roaming. [44] . In particular, the European Parliament and the Council should agree towards more harmonisation for spectrum policy in the current negotiation process. Conversely, we submit that EU intervention is not justified for national market analysis, when there is little impact on the internal market or where there is uncertainty on the most appropriate regulatory approach. In particular, the Commission should use its new power on the choice of regulatory remedies with great care, showing each time why the choice of a particular remedy would affect trade between Member States and the internal market. Such care is particularly relevant regarding the regulation of Next Generation Networks where uncertainty remains on the appropriate regulatory approach to stimulate investment; hence regulatory experimentation would be useful. [45] In addition, the EU should provide support for small regulators which so request. [46] The regulatory framework is complex and regulators in small countries do not necessarily have the resources to meet their duty. That problem will become even more acute with the next wave of accession countries (*i.e.* Balkans countries).

The European legislative process has been the battleground for arbitrating the political debate on striking the balance between the EU and national regulation. But since the liberalisation of 1998, the battle has been more intellectual than political, with winning ideas trialled by the most innovative national regulators being subsequently implemented in other countries. Over the years, depending on the issues, specific Member States or sometimes the Commission itself have been in the driving seat in terms of generating new regulatory ideas. Because of that and because it has limited resources and political capital, the Commission should not seek to intervene on every regulatory issue, in particular in the absence of a reasonable consensus. A case in point is the upcoming Commission recommendations

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44 Network security and standardisation are also cases for EU intervention according to the criteria of fiscal federalism.

45 More generally, we submit that EU intervention is more relevant for the content part of digital regulation (such as copyright, privacy, electronic commerce, dispute resolution) than for the infrastructure part (i.e. the electronic communications networks and services), as the former is based on tradable goods whereas the latter is mainly based on local non-tradable goods.

46 This is in line with Article 16(7) of the amended Framework Directive 2002/21, and Article 3(1c) of the Regulation 1211/2009 of the European Parliament and of the Council of 25 November 2009 establishing the Body of European Regulators for Electronic Communications (BEREC) and the Office, *OJ* [2009] L 337/1. More generally, see the new Art. 197 TFUE on administrative cooperation.

on cost methodologies for key access products which would cover NGA pricing. Instead, the European Commission should concentrate its action on measures essential for the achievement of the internal market for electronic communications.

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